Airlines

Recent Developments Expected To Produce Large Industry Loss

Companies Mentioned: ALK, AMR, AWA, CAL, DAL, LUV, NWAC*, U, UAL

ABN·AMRO

September 17, 2001

Flashnote

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Highlights

- **On Tuesday, September 11th, two UAL and two American Airlines planes were hi-jacked and crashed on the East Coast. These occurrences caused the industry and financial markets to brace themselves for the uncertainty that resulted with the U.S. equity markets being closed for the remainder of the week.**
- **Prior to these tragic developments we were already pessimistic on the industry as a result of the slow economy, continuing high fuel prices, and labor problems at many carriers. However, with these recent developments this view is now more negative. Airline operations were shutdown for the large part of three days following the terrorist acts and we estimate that the industry lost approximately $270 million per day in revenues because of the shut down. Some carriers only resumed partial service on Friday and how quickly operations will return to normal remains to be seen.**
- **We expected the industry to have a bad year, but we now believe it could be a very bad year. Our estimate for a loss for the industry was roughly $2.5 billion (mostly related to the large losses anticipated by UAL and US Airways); however, we now believe that this year's expected loss could break the 1992 record loss of $4.6 billion.**
- **However, we believe the airline industry, in general, is in a much stronger position now than in 1992 to weather this difficult environment. We believe that generally the airlines' liquidity and balance sheets are stronger and that no companies are in immediate danger of bankruptcy. We maintain our Hold ratings on the 8 major network carriers and suggest that investors avoid investing in all non-regional airlines for the time being as a result of the lack of consumer confidence, the already weak economy and industry problems.**

Reason for note: Industry Developments

On Tuesday, September 11th, two UAL (NYSE: UAL- 30.82, Hold) and two American Airlines (NYSE: AMR- 29.70, Hold) planes were hi-jacked and crashed on the East Coast. These occurrences caused the industry and financial markets to brace themselves for the uncertainty that resulted with the U.S. equity markets being closed for the remainder of the week. Upon the crashes the FAA shut down the domestic air transportation system, which was a first in U.S. history. The shut down left passengers stranded and the industry unable to generate revenues to offset the many fixed costs that it is still incurring. We estimate the major domestic carriers lost approximately $270 million in revenues per day during the shutdown.

Prior to these tragic developments we were already pessimistic on the industry as a result of the slow economy, continuing high fuel prices, and labor problems at selected carriers, but now this view has grown much more negative. Airline operations were shut down for the better part of three days following the terrorist acts and we estimate that the industry lost roughly $270 million per day in revenues because of the shut down. Some of the carriers began limited service on Friday, but the time frame for a return to normal operations is still uncertain. For the time being there have been restrictions instituted for cargo transportation on commercial airlines, which is resulting in lost revenues. Revenues from cargo transportation account for approximately 4% to 5% of total revenues for some major domestic carriers. We are also unsure of how quickly travelers will return to air travel after the scare from terrorism. In particular we are concerned about consumer confidence and believe that any significant decrease in travel could send the industry into a further tailspin.

The IATA (International Air Transport Association) has estimated that the global airline industry could lose approximately $10 billion as a result of the actions that occurred last week. However, it remains to be seen how far traffic will fall off and to what extent the carriers will cut back on operations to understand if a loss of this magnitude will be realized. Some carriers have already announced layoffs and reduced flight schedules to help control losses. We estimate that the loss for the major U.S. network carriers could be in the $4 to $5 billion range. We believe that traffic could initially fall off between 20% to 50%, but after that the U.S. reaction the recent events and any further economic weakening could cause a fall off in traffic to be prolonged.

We expected the industry to have a bad year, but we now believe it could be a very bad year. Our estimate for a loss for the industry was roughly $2.5 billion, more than half derived from expected losses by UAL and US Airways (NYSE: U- 11.62, Hold). However, we now believe that this year's anticipated loss could break the 1992 record loss of $4.6 billion (before extraordinary items). However, we believe the airline industry is in a much better position now than in 1992 to weather the difficult environment. We believe that the airlines' liquidity and balance sheets are stronger and that no companies are in any immediate danger of bankruptcy. We maintain our Hold ratings on the 8 major network carriers and suggest that investors avoid investing in all non-regional airlines for the time being as a result of the uncertain economic and industry situation. The airline industry is a fragile industry at this point, but a very important economic engine for the national and global economy. Consequently, the government may have to step in and offer relief from added security costs and fuel related expenses to help the carriers through this crisis and avoid a liquidity crunch. An initial proposal for government help consisting of $2.5 billion in cash assistance and $12.5 billion in loan guarantees was rejected by the House of Representatives, but we believe this help may be needed depending upon how bad traffic falls off.

Estimated Daily Loss For The Major Carriers

Company	Revenues/Day	Expenses/Day
ALK	6.4	6.4
AMR	61.7	62.6
AWA	6.8	7.0
CAL	25.8	25.8
DAL	46.3	45.1
LUV	17.2	14.5
NWAC	29.1	29.4
U	24.4	26.9
UAL	51.0	55.9
Total	**268.7**	**273.6**

Source: ABN Amro Incorporated estimates

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